

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-305

July 14, 1999

BANGOR HYDRO-ELECTRIC COMPANY
Request for Advisory Ruling on Whether
Bangor Hydro-Electric Company Meets the
Requirements of Section 5(A) of Chapter 820
of the Commission Rules

ADVISORY RULING

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

In this Advisory Ruling, we conclude that Standard & Poor's rating of BBB- on Bangor Hydro-Electric Company's senior secured debt meets the definition of "investment grade bond rating" as that term is used in Chapter 820 of the Commission's rules.

II. BACKGROUND AND DISCUSSION

On May 6, 1999, Bangor Hydro-Electric Company (BHE) filed a petition for an Advisory Ruling pursuant to Chapter 110, part 6, of the Commission's rules. Specifically, BHE requests that the Commission determine that BHE has attained an "investment grade bond rating" within the meaning of Chapter 820 of the Commission's Rules and, therefore, meets the requirements of Section 5(A) of Chapter 820.

In Docket No. 97-796, BHE asserted that if it received a rating higher than BB+ on its senior secured debt securities, then BHE would meet the investment grade bond rating test under Chapter 820. Chapter 820 allows a utility with an investment grade bond rating to invest in an affiliate without Commission approval if the utility's cumulative investment in all non-core activities does not exceed 5 percent of that utility's total capitalization. MPUC Rules, ch. 820, § 5(A). In our Phase II Order in Docket No. 97-796, we determined that the issue of whether BHE had attained an investment grade bond rating should be reserved for a future proceeding. *Bangor Hydro-Electric Company, Petition for Affiliated Approval Needed in Connection with Bangor Gas Company Transaction*, Docket No. 97-796, Order (Phase II)(October 30, 1998).¹ In our Order on Request for Reconsideration, we gave BHE

¹ In our Phase II, Order we allowed BHE to invest up to \$1,224,000 in Bangor Gas Company (BGC). In our Order on Request for Reconsideration, we clarified that any development costs expended after August 31, 1998 could be added to the amount of BHE's next proposed investment in BGC. Under the current construction budget, BHE may be required to make capital contributions between \$7 million and \$10 million in 1999.

the option of resolving this question either by filing for a determination that it need not seek approval because it had attained the necessary rating, or by requesting an advisory ruling on whether it meets the requirement of section 5(A) of Chapter 820. BHE has chosen the latter option. Since we already determined that this matter is appropriate for an advisory ruling, the General Counsel need not recommend whether an advisory ruling should be issued. See MPUC rules, ch. 110, § 603. We, therefore, waive this requirement. MPUC Rules, ch. 110, § 103.

BHE's advisory ruling request raises the question of whether a utility has attained an investment grade bond rating within the meaning of that term in Chapter 820 when a utility's rating on its senior secured debt under Standard & Poor's "ultimate recovery analysis" is above BB+ but its corporate credit rating has not exceeded BB+. Investment Grade Bond rating is defined in Chapter 820 as:

a rating for senior secured debt of above BB+ for Standard & Poor's, Duff and Phelps Credit Rating Company or Fitch Investor's Service or above Ba1 for Moody's Investor Service. If a utility is not publicly rated, investment grade bond rating may be determined by a private letter rating.

MPUC Rules, ch. 820, § 2(H). BHE has provided a Standard and Poor's press release indicating that on February 25, 1999, Standard & Poor's assigned its BB+ corporate credit rating to Bangor Hydro-Electric Company and assigned its rating of BBB- to Bangor Hydro's senior secured debt and secured revolving credit (Revolver) and term loan agreements. As required in the Order on Reconsideration, BHE also supplied a copy of a letter from its lender, BankBoston, indicating that the rating of BBB- on Bangor's senior secured debt triggered a change in the credit pricing under the Revolver and Term loans.

We are satisfied that the rating on BHE's senior secured debt meets both the letter and the spirit of the provisions in Chapter 820. The rating certainly meets the literal definition of investment grade bond rating set forth in Chapter 820. We requested the confirmation from BHE's lenders, however, to ensure that Standard & Poor's relatively new "ultimate recovery analysis" did not create a loophole that might allow a high-risk utility to qualify for the investment-without-review option intended to be available under Chapter 820 only to financially sound utilities.

In our Order provisionally adopting Chapter 820, we stated:

We determine that the bond rating provides an objective criterion for determining the financial health of the utility seeking to invest in a non-core venture. Rating agencies base their opinions on factors

BHE states that it is currently renegotiating the construction budget with SEMPRA so that it may make a significantly smaller contribution than originally anticipated. In Docket No. 98-555, we allowed BHE to invest up to \$680,000 in its CareTaker venture.

such as cash flow and debt service coverage ratios. We believe that it is reasonable to rely on such agencies' expertise in determining the financial health of a utility.

Requirements for Non-Core Utility Activities and Transactions between Affiliates (Chapter 820), Docket No. 97-886, Order Provisionally Adopting Rule and Statement of Factual and Policy Basis (February 18, 1998). The rule thus uses the bond rating to determine the financial health of the utility.

Standard & Poor's notes that prior to its implementation of its ultimate recovery analysis, the rating on senior secured debt was determined by the Company's corporate credit rating (CCR). See attached press release from Standard & Poor's. Therefore, the rating on senior secured debt would be based on the same rigorous analysis of the utility's financial health as the corporate credit rating. However, under Standard & Poor's ultimate recovery analysis, a security's rating may be enhanced one or two notches above the CCR if Standard & Poor's concludes "that full recovery of principal can be anticipated in a post-default scenario." In the February 1999 press release regarding BHE's rating upgrade, Standard & Poor's explains the difference between BHE's CCR and its higher rating on senior secured debt:

The higher rating on Bangor Hydro's secured debt reflects the impact of Standard & Poor's ultimate recovery analysis. Under this analysis, Standard & Poor's projects that in a post-default scenario the value of the utility's assets would substantially exceed the amount of first mortgage bonds that could be outstanding under the indentures' terms. Therefore, Standard & Poor's is highly confident that first mortgage bond holders would receive their principal in a bankruptcy scenario.

Since this analysis is directed at whether the utility's assets provide sufficient collateral for the amount that could be outstanding under the terms of the notes, it does not provide the depth and breadth of financial analysis we envisioned in developing the standard for an investment-without-review option under Chapter 820. However, in BHE's case, the fact that an existing lender accepts the rating as evidence of an investment grade rating² weighs in favor of considering this rating consistent with the purposes of Chapter 820. The lender's view of BHE as financially healthy enough to trigger a reduction in interest costs significantly reduces ratepayer protection concerns that might be present if a utility were not financially healthy but nevertheless had attained an investment grade rating on its senior secured debt. We also note that in addition to a ratings upgrade, Standard & Poor's considers BHE's outlook to be positive.

² Under the Term and Revolver loan, an investment grade bond rating triggers a credit price reduction.

We are concerned about circumstances where Standard & Poor's split ratings might create a loophole. Thus, we will consider amending Chapter 820 to take into account the situation where a utility is not financially healthy but has attained an investment grade bond rating on its senior secured debt.³

For the above reasons, we conclude that BHE's rating on its senior secured debt under Standard & Poor's ultimate recovery analysis meets the definition of investment grade bond rating within the meaning of the rule. This means that absent any future reduction in BHE's rating, it may invest a total of up to 5% of its total post-divestiture capitalization in non-core ventures.⁴

Dated at Augusta, Maine, this 14th day of July, 1999.

BY ORDER OF THE COMMISSION

Raymond Robichaud
Assistant Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

³ One way to avoid this disparity in ratings is to amend the rule by substituting the phrase "corporate credit rating" for the phrase "senior secured debt".

⁴ BHE projects that 5% of its post-divestiture capitalization would be \$15 million. Samp Affidavit, ¶18.